88-120

No.

IN THE

# Supreme Court of the United States

October Term, 1988

VENITA VANCASPEL, et al.,

*Petitioners,*

v.

CHARLES T. CORWIN, D.D.S., et al.,

*Respondents.*

## JOINT PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Robert R. Roby
Gary D. Lykins
Max E. Freeman, II
*(Counsel of Record)*
GWINN & ROBY
4100 Renaissance Tower
1201 Elm Street
Dallas, Texas 75270
(214) 698-4100

Stephen R. Kirklin
Jack J. Garland, Jr.
Jack Chapline Vaughan, Jr.
KIRKLIN & BOUDREAUX
1800 InterFirst Plaza
Houston, Texas 77002
(713) 757-0000

*Counsel for Petitioners, Venita VanCaspel and VanCaspel & Co., Inc.*

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## QUESTIONS PRESENTED

I. Whether the Fifth Circuit decision is in conflict with the Third Circuit and this Court's guidance set forth in *Agency Holding Corp. v. Malley-Duff & Associates, Inc.* as to the proper approach to the determination of the applicable period of limitations for implied causes of action for civil violations of federal securities laws?

II. Whether the public interests to be served and need for uniformity, certainty and minimization of unnecessary disputes in federal securities litigation demand that a single limitations period be selected from the most analogous federal statute?

III. Whether the schema of limitations in the Securities Exchange Act of 1934 clearly provides a closer analogy than available state statutes when considering the federal policies at stake and the practicalities of litigation?

IV. Whether Respondents' claims of alleged violations of federal securities laws are time-barred by the appropriate period of limitations?

## PARTIES TO THE PROCEEDINGS

CHARLES T. CORWIN, D.D.S.; THE ESTATE OF RICHARD P. MULLINS, DECEASED; DONALD T. BOUDREAUX AND PATRICIA E. BOUDREAUX, his wife; and HAROLD O. HUDNALL AND AUDREY S. HUDNALL, his wife, were Appellants in the United States Court of Appeals for the Fifth Circuit.

MARNEY, ORTON INVESTMENTS, a General Partnership; THE ESTATE OF RONALD D. MARNEY, DECEASED: SIDNEY ORTON; MOH, INC.; VENITA VANCASPEL; VANCASPEL & CO., INCORPORATED; AND SUZANNE M. MARNEY were Appellees in the United States Court of Appeals for the Fifth Circuit.

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## JOINT PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners, Venita VanCaspel and VanCaspel & Co., Incorporated respectfully request that a writ of certiorari issue to review the judgment and decision of the United States Court of Appeals for the Fifth Circuit entered on April 26, 1988.

## OPINIONS BELOW

The second opinion of the United States Court of Appeals for the Fifth Circuit on this matter is reported at 843 F.2d 194 and is provided in the Appendix (A-1). The District Court's ruling granting the Petitioners' motion for summary judgment is not officially reported, but is provided in the Appendix (E-1).

## JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered on April 26, 1988. Petitioners' motion for leave to file a petition for rehearing out of time was granted on June 3, 1988. Their petition for rehearing was denied on June 3, 1988. Copies of these orders are provided in the Appendix. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

This petition for a writ of certiorari was filed within 90 days of April 26, 1988, the date of the final decision of the Court of Appeals for the Fifth Circuit.

## STATUTES INVOLVED

The Securities Act of 1933, 15 U.S.C. §§ 77*a et seq.* provides in relevant part:

> No action shall be maintained to enforce any liability created under Section 77*k* or 77*l*(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under Section 77*l*(1), unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce the liability created under Section 77 or Section 77*l*(1) more than three years after the security was bona fide offered to the public, or under Section 77*l*(2) more than three years after the sale.

*Id.* at § 77*m*.

The Securities Exchange Act of 1934, 15 U.S.C. §§ 78*a* *et seq.*, provides in relevant part:

> No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

*Id.* at § 78*i*(e)

> No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued.

*Id.* at § 78*r*(c).

The relevant Texas statute for fraud in real estate and stock transactions, Tex. Bus. & Com. Code Ann. § 27.01 (Vernon 1987) provides:

(a) Fraud in a transaction involving real estate or stock in a corporation or joint stock company consists of a

(1) false representation of a past or existing material fact, when the false representation is

(A) made to a person for the purpose of inducing that person to enter into a contract; and

(B) relied on by that person in entering into that contract; or

(2) false promise to do an act, when the false promise is

(A) material;

(B) made with the intention of not fulfilling it;

(C) made to a person for the purpose of inducing that person to enter into a contract; and

(D) relied on by that person in entering into that contract.

(b) A person who makes a false representation or false promise commits the fraud described in Subsection (a) of this section and is liable to the person defrauded for actual damages.

(c) A person who makes a false representation or false promise with actual awareness of the falsity thereof commits the fraud described in Subsection (a) of this section and is liable to the person defrauded for exemplary damages. Actual awareness may be inferred where objective manifestations indicate that a person acted with actual awareness.

(d) A person who (1) has actual awareness of the falsity of a representation or promise made by another person and fails to disclose the falsity of the representation or promise to the person defrauded, and (3) benefits from the false representation or promise commits the fraud described in Subsection (a) of this section and is liable to the person defrauded for exemplary damages. Actual awareness may be inferred where objective manifestations indicate that a person acted with actual awareness.

(e) Any person who violates the provisions of this section shall be liable to the person defrauded for reasonable and necessary attorney's fees, expert witness fees, costs for copies of depositions, and costs of court.

Tex. Bus. & Com. Code Ann. § 27.01 (Vernon 1987).

The relevant statute of limitations governing causes of action for fraud under Texas law provides:

> A person must bring suit for trespass for injury to the estate or to the property of another, conversion of personal property, taking or detaining the personal property of another, personal injury, forcible entry and detainer and forcible detainer not later than two years after the day the cause of action accrues.

Tex. Civ. Prac. & Rem. Code Ann. § 16.003 (a) (Vernon 1986).

## STATEMENT OF THE CASE

This suit is before this Court following the second appeal after the rendition of a second summary judgment by the district court in favor of Petitioners on the basis of limitations. Respondents filed suit in federal district court on September 4, 1984 charging Petitioners with violations of the Securities Act of 1933, the Securities Exchange Act of 1934 and the Racketeer-Influenced and Corrupt Organizations Act ("RICO") by reason of the alleged securities-fraud violations. Various state law claims were also alleged.

On appeal for the first time, the United States Court of Appeals for the Fifth Circuit affirmed the dismissals of

claims under the Securities Act of 1933 and the Investment Advisors Act of 1940, but reversed the dismissals of the Rule 10b-5, RICO and state-law claims, remanding the case for proceedings consistent with its opinion. *Corwin v. Marney, Orton Investments,* 788 F.2d 1063 (5th Cir. 1986) *(Corwin I)* The Fifth Circuit suggested the district court determine when the investors discovered (or reasonably should have discovered) the basis of their claims to ascertain when the two-year period of limitations began to run for Rule 10b-5 claims in Texas, having held the Texas two-year statute of limitations applicable to fraud actions under § 27.01 of the Texas Business & Commerce Code to be the most analogous Texas statute for purposes of ascertaining the period of limitations for such implied federal causes of action.

On remand, Petitioners again filed for summary judgment contending the securities-fraud claims were barred by limitations. The United States District Court (Ross N. Sterling, presiding) considered the claims, heard the relevant evidence tendered by all parties and determined that Respondents' claims were barred by limitations. (D-1). Respondents thereafter appealed for the second time to the Court of Appeals for the Fifth Circuit. On appeal, the Court of Appeals for the Fifth Circuit held the appropriate limitations period for Rule 10b-5 claims in Texas to be two years, again applying the period of limitations applicable to the most analogous *state* statute. The Court of Appeals for the Fifth Circuit further applied the federal equitable tolling doctrine and held the period of limitations did not begin to run until the respondents discovered, or reasonably should have discovered, the petitioners' alleged misdeeds. *Corwin v. Marney, Orton Investments,* 843 F.2d 194, 197 (5th Cir. 1988) *(Corwin II). See also Jensen v. Snellings,* 841 F.2d 600 (5th Cir. 1988)

Petitioners herein, having become aware of the recent Third Circuit opinion of *In Re Data Access Systems Securities Litigation*, 843 F.2d 1537 (3rd Cir. 1988), filed for leave to file their petition for rehearing out of time. Petitioners' motion for leave was granted on June 3, 1988 (B-1); however, their petition for rehearing was denied on the same date (D-1).

Petitioners are now asking this Court to grant review of the important questions of policy and substantive law, thereby resolving substantial problems which currently exist within the areas of federal securities laws.

## STATEMENT OF THE FACTS

Respondents are all members of a group of investors asserting disputes over their investment in a tax-sheltered, limited partnership having as its purpose, the building, operating and selling of a commercial office building in Houston, Texas. Respondents purchased their respective interests in this tax-sheltered limited partnership in December 1980. Their claims generally relate to alleged misrepresentations and alleged omissions of material fact. Respondents filed suit September 4, 1984 in the United States District Court for the Southern District of Texas (Ross N. Sterling, presiding).

Venita VanCaspel, Petitioner herein, was the registered representative and broker-dealer involved in the offering of these tax-sheltered limited partnerships for sale. Petitioner, VanCaspel & Co., Incorporated, was the stockbrokerage firm in which Venita VanCaspel was an employee.

## REASONS FOR GRANTING THE WRIT

### I. THE FIFTH CIRCUIT DECISION IS IN CONFLICT WITH THE THIRD CIRCUIT AND THIS COURT'S GUIDANCE SET FORTH IN *AGENCY HOLDING CORP. v. MALLEY-DUFF & ASSOCIATES, INC.* AS TO THE PROPER APPROACH TO THE DETERMINATION OF THE APPLICABLE PERIOD OF LIMITATIONS FOR IMPLIED CAUSES OF ACTIONS FOR CIVIL VIOLATIONS OF FEDERAL SECURITIES LAWS.

There is conflict among the circuit courts of appeals over the proper approach to the determination to the applicable period of limitations for implied causes of action for civil violations of federal securities laws.

The Court of Appeals for the Fifth Circuit continues to hold the period of limitations for violations of federal securities laws is the forum state's statute of limitations applicable to the most analogous state cause of action. *See Corwin v. Marney, Orton Investments*, 834 F.2d 194, 197 (5th Cir. 1988) *(Corwin II); Jensen v. Snellings*, 841 F.2d 600 (5th Cir. 1988).

Contrarily, the Court of Appeals for the Third Circuit has recently held that the schema of limitations contained in the Securities Exchange Act of 1934 is the *most* appropriate period of limitations governing implied private causes of action for civil violations of federal securities laws (notably Section 10(b) of the 1934 Act and Rule 10b-5 thereunder). The Court of Appeals for the Third Circuit based its opinion upon the important federal policies at stake and the legislative history of the federal securities laws, recognizing the wide variations between circuit courts of appeals in

addressing such limitations questions. *In Re Data Access Systems Securities Litigation*, 843 F.2d 1537, 1550 (3rd Cir. 1988). *See also Davis v. Birr, Wilson & Co., Inc.* 839 F.2d 1369 (9th Cir. 1988) (Aldisert, J., *concurring*).

The Fifth Circuit failed to follow this Court's guidance set forth in *Agency* , wherein this Court set forth the necessity of establishing a uniform limitations period, rejecting "color-matching" or the claim-by-claim analysis previously applied by courts. *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, ___ U.S. ___, 207 S.Ct. 2759, 97 L.Ed.2d 121 (1987); *Wilson v. Garcia*, 471 U.S. 261, 105 S.Ct. 1938, 85 L.Ed.2d 254 (1985); *Del Costello v. International Brotherhood of Teamsters*, 462 U.S. 151, 103 S.Ct. 2281, 76 L.Ed.2d 476 (1983). *See also Biggans v. Bache Halsey Stuart Shields, Inc.*, 638 F.2d 605 (3rd Cir. 1980). To implement this Court's mandate, the courts below must borrow a more appropriate period of limitations from federal law when state law provides an unsatisfactory vehicle for the enforcement of federal laws when weighed against the important federal policies at stake and the practicalities of litigation such as the need to minimize uncertainty and achieve uniformity in judgments.

## II. THE PUBLIC INTERESTS TO BE SERVED AND NEED FOR UNIFORMITY, CERTAINTY AND MINIMIZATION OF UNNECESSARY DISPUTES IN FEDERAL SECURITIES LITIGATION DEMAND THAT A SINGLE LIMITATIONS PERIOD BE SELECTED FROM THE MOST ANALOGOUS FEDERAL STATUTE.

The Securities Act of 1933 and the Securities Exchange Act of 1934 provide uniquely federal claims and remedies. Any application of a state limitations period to those federal statutory actions and remedies is, at best, a crude approximation of the federal policies prohibiting stale claims and encouraging expediency in bringing such claims as well as the policy of stabilizing our national economy. The attempts to analogize state statutes of repose to these uniquely federal actions and remedies only complicates and continues the confusion, complexity and inconsistent results contrary to the very policies meant to be served by the federal statutes.

Many legal scholars and members of the bar have recognized this as an area of tremendous confusion with inconsistent results and have pleaded for help in this vexing area "with a unanimity rare in law." *Data Access*, 843 F.2d at 1540. *See also* N. Sobol, *Determining Limitation Periods for Actions Arising Under Federal Statutes*, 41 Sw.L.J. 895 (1987); *Report of the Task Force on Statute of Limitations for Implied Actions*, 41 Bus.Law. 645 (1986); T. Hazen, *The Law of Securities Regulations* § 13.8 & n. 2 (1985) (collecting authority); L. Loss, *Fundamentals of Securities Regulations*, 1164-75 (1983). In fact, as the Court of Appeals for the Third Circuit aptly noted, the absence of a uniform limitations period in such actions is "one tottering parapet of a ramshackle edifice. Deciding what features of state periods of limitations to adopt for which federal statutes wastes untold hours." *Data Access*, 843 F.2d at 1539. *See also Norris v. Wirtz*, 818 F.2d 1329, 1332 (7th Cir.), *cert. denied*, ___ U.S. ___, 108 S.Ct. 329, 98 L.Ed.2d 356 (1987).

Petitioners recognize the normal deference of federal courts to state statutes of limitations most analogous to each individual case whenever a federal statute is silent on the proper limitations period; however, a clear majority of this Court rejected such a single path in *Del Costello* and again in

*Agency*. *See also* Rules of Decision Act, 28 U.S.C. § 1652 (1982 & Supp. 1988).

This Court has previously outlined the procedure courts should follow in determining the appropriate statute of limitations for a federal claim. Initially, the court must determine whether all claims arising out of the federal statute should be characterized in the same way or evaluated differently, depending upon the varying factual circumstances and legal theories presented in each particular case. *Agency*, ___ U.S. at ___, 107 S.Ct. at 2762; *Wilson*, 471 U.S. at 268, 105 S.Ct. at 1943. After the court has made such a determination, the next inquiry is whether a federal or state statute should be borrowed for implementation. Pursuant to the Rules of Decision Act, 28 U.S.C. § 1652, this Court has held that state statutes are to be applied to federal statutory actions not covered by an express limitations period unless a timeliness rule drawn from elsewhere in federal law should be applied. Weighing these factors, this Court has concluded that state statutes are unsatisfactory for the enforcement of certain areas of federal law, reasoning it inappropriate to conclude that Congress would have intended to adopt state statutes at odds with the very purposes and policies underlying the federal substantive law. In fact, this Court has not hesitated to turn away from state law and apply more appropriate federal timeliness rules when a rule from elsewhere in federal law clearly provides a closer analogy than available state statutes, especially when the federal policies at stake and the practicalities of litigation make the federal rule more appropriate for interstitial lawmaking. *Del Costello*, 462 U.S. at 161, 1035 S.Ct. at 2289; *Agency*, ___ U.S. at ___, 107 S.Ct. at 2767 (four year statute of limitations governing Clayton Act civil enforcement suits applies to RICO civil enforcement actions); *Occidental Life Ins. Co. v. EEOC.*, 432 U.S. 355, 97 S.Ct. 2447, 53 L.Ed.2d 402 (1977)(adopting federal statute of limitations for EEOC

enforcement actions); *McAllister v. Magnolia Petroleum Co.*, 357 U.S. 221, 78 S.Ct. 1201, 2 L.Ed.2d 1272 (1958)(federal limitations period applied to unseaworthiness action under general admiralty law); *Holmberg v. Armbrecht*, 327 U.S. 392, 66 S.Ct. 582, 90 L.Ed. 743 (1946)(refusing to apply state limitations period to action to enforce federally created equitable right).

The approach taken by this Court in addressing limitations for implied rights of action under other statutes, provides a solid foundation for similar reasoning and analysis in federal securities cases.

This court has already recognized that Section 10(b) and Rule 10b-5 actions and common law fraud actions are two distinctly different species. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390, 103 S.Ct. 683, 691, 74 L.Ed.2d 548 (1983). Congress, by the enactment of the federal securities laws, recognized that state common law doctrines of fraud are not co-extensive with the federal policies served by the federal securities laws. This Court now has the opportunity to recognize these distinctions underlying the decision of Congress to enact the federal securities laws.

## III. THE SCHEMA OF LIMITATIONS IN THE SECURITIES EXCHANGE ACT OF 1934 CLEARLY PROVIDES A CLOSER ANALOGY THAN AVAILABLE STATE STATUTES WHEN CONSIDERING THE FEDERAL POLICIES AT STAKE AND THE PRACTICALITIES OF LITIGATION.

Congress provided several periods of repose in the numerous provisions of the federal securities laws. When Congress enacted the Securities Exchange Act of 1934, it amended the 1933 limitations statute (15 U.S.C. § 77*m*) and

specified a new statute of limitations for each of the express rights of actions it created.

Congress declared with specificity:

> No action shall be maintained to enforce any liability created under Section 77*k* or 77*l*(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce any liability created under Section 77*l*(1) of this title, unless brought within one year after the violation upon which it is based. *In no event shall any such action be brought to enforce a liability created under Section 77k or 77l(1) of this title more than three years after the security was bona fide offered to the public, or under 77l(2) of this title more than three years after the sale* (emphasis added).

15 U.S.C. § 77*m*.

Additional periods of repose enacted by Congress provide in relevant part:

> No action shall be maintained to enforce any liability created under this section [15 U.S.C. § 78*i*], *unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation. (emphasis added).*

> No action shall be maintained to enforce any liability created under this section [15 U.S.C. § 78*r*] *unless brought within one year after the discovery of the facts constituting the cause of action and within three*

*years after such causes of action accrued (emphasis added).*

15 U.S.C. § 78*i*(e), 15 U.S.C. § 78*r*(c), respectively.

Petitioners contend the one-year-after-discovery and three-years-after-the-violation schema is better suited for application to implied causes of action for civil violations of federal securities laws than available state statutes. Furthermore, there are reasons for the periods of repose as enacted by Congress.

In reviewing the legislative history of the 1934 Act, it is clear that Congress feared the disruption of our economic system. Lingering liabilities impede normal business and facilitate false or weak claims. It was understood that the three year rule was *absolute* to allow those in the securities industry the ability to accurately assess their liability and potential for exposure. There is also a strong overriding federal interest in requiring a plaintiff to file suit quickly. Such a suit will alert other investors to possible misconduct and will also allow those in the securities industry to treat a given transaction as closed, allowing them to proceed with handling other affairs. *See Report of the Task Force on Statute of Limitations for Implied Actions*, 41 BUS.LAW. 645, 655 (1986); 6 J.S. Ellenberger & E. Mahar, *Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934*. 6565-66, 6718, 6993 (1973) and 7 *id.* at 7743-44.

Federal securities law primarily stems from two landmark statutes: the Securities Act of 1933 and the Securities Exchange Act of 1934. The 1933 Act was enacted to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce, while the 1934 Act was enacted to regulate securities exchanges and to prevent inequitable and unfair practices.

Having briefly reviewed the purposes and legislative history of the federal securities laws, Petitioners now focus upon the principles set forth by this Court in *Del Costello*. In *Del Costello*, this Court mandated borrowing a state statute when appropriate but also recognized that "when the federal policies at stake and the practicalities of litigation make [a federal] rule a significantly more appropriate vehicle for interstitial lawmaking," the court should borrow a federal statute. *Del Costello*, 462 U.S. at 172. This Court has recently recognized that an application of a uniform federal statute of limitations is required to avoid intolerable uncertainty and time-consuming litigation in RICO actions. *Agency*, ___ U.S. at ___, 107 S.Ct. at 2764 (quoting *Wilson*, 471 U.S. at 272, 105 S.Ct. at 1945).

The Third Circuit (in contrast with the Fifth Circuit) has found guidance from the recent decisions of this Court when dealing with questions of limitations in federal securities litigation. Federal securities litigation, like RICO and § 1983 actions, require a uniform statute of limitations to avoid intolerable uncertainty and time consuming litigation. *Data Access*, 843 F.2d at 1548. Application of the *Agency* "far closer analogy" test leads to the clear conclusion that Section 10(b) of the Securities Exchange Act of 1934 (and Rule 10b-5 thereunder) bears a far closer analogy to companion provisions in the 1934 Act than any state alternative. *Id.*

Both Section 10(b) and all companion provisions are aimed at the same objective. All of the provisions, except section 16(b), have a uniform federal limitations period. All reflect, in common with Section 10(b), the purpose of the original Securities Act of 1933. All aim to compensate the same type of injury. All are designed to fill a void in state common law and to create remedies which would be uniform throughout our nation's commercial universe, instead of being subjected to the vagaries of independent and diverse state statutory regulations not drafted with the federal

policies at stake in mind. Furthermore, the application of varying state statutes is contrary to the reason Congress enacted the Securities laws (responding to the critical need for national uniformity of remedies for securities violations within all states). *Id.*

The need for uniform federal remedies in securities cases begs for application of a uniform federal statute of limitations. The problems of uncertainty and varying results are, under the present scheme, almost infinite and very real. In any given typical transaction, people are often involved from different states, with each state having different applicable statutes of limitations. For example, a broker-dealer might be located in Texas, the purchaser in California, the attorney in Pennsylvania and the accountant in Montana. Conceivably, the same transaction could result in inconsistent results for the various defendants if brought separately since uniformity is not to be found within the range of state limitations statutes.

With all of this in mind, one cannot conceive of a limitations period better serving the federal policies at stake and which considers the practicalities of litigation for claims asserted under federal securities laws than the provisions of the federal securities laws that expressly and explicitly define such a period. As the Court of Appeals for the Third Circuit has stated:

> [i]ndeed, because the Supreme Court opened the door to borrowing relevant federal limitations statutes, and in light of the congressional philosophies and purposes set forth in the 1933 and 1934 Acts that have been so consistently emphasized and implemented by the federal courts, it would seem bizarre if not anomalous to go beyond

> the express statutes of limitations contained in the provisions of the 1934 Act.

*Data Access*, 843 F.2d at 1549.

Petitioners recognize that the Supreme Court has yet to rule on the applicable limitations period for Section 10(b) and Rule 10b-5 actions. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n. 29 (1976). Because there are many potentially (though significantly less) analogous state statutes with variations of different kinds of securities offenses and different circumstances that might toll the period of limitations, because both the bar and scholars have found the subject vexing and have pleaded for help and guidance, and because the courts of appeals disagree on nearly every conceivable issue about limitations periods in securities cases, a significant public interest and this Court's immediate interest in the orderly administration of justice in the lower federal courts will be furthered if this Court were to address the issues presented at this time and enter a ruling which establishes a truly uniform and truly predictable limitations period for Section 10(b) and Rule 10b-5 implied private civil actions. Such a ruling will resolve the discrepancies in the lower federal courts and provide the necessary predictability of results that our federal securities laws deserve.

## CONCLUSION

Present case law calls for difficult interpretations of state limitations periods. Litigants are required to examine each contention of a federal securities complaint with microscopic particularity to determine whether the state blue sky statutes or state fraud statutes best track the particular federal claims, and if not, to determine which other state

limitations period will apply, depending upon the resemblance between the precise federal claim and those based in state or common law actions. This system presently ignores the federal policies at stake in such litigation.

In *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, ___ U.S. ____, 107 S.Ct. 2759, 97 L.Ed.2d 121 (1978), this Court provided a formula to approach the present problem. This Court stated that although it has been suggested that federal courts always should apply the state statute of limitations most analogous to each individual case whenever a federal statute is silent on the proper limitations period, deference to federal law is *required* when the federal rule clearly provides a closer analogy than available state statutes given the federal policies at stake and the practicalities of litigation. In these instances it is inappropriate to conclude that Congress would choose to adopt state rules at odds with the purposes of operation of federal substantive law. *Id.*

The Supreme Court has already recognized the necessity for establishing a uniform limitations period when resorting to "borrowing" state law. *Id.* A factual, claim-based approach to categorizing the case for limitations purposes does not promote "[t]he federal interests in uniformity, certainty, and the minimization of unnecessary litigation." *Wilson*, 471 U.S. at 275.

Petitioners are impressed by the approach taken by the Court of Appeals for the Third Circuit sitting *en banc* and ask this Court to adopt the same reasoning in Section 10(b), Rule 10b-5 and federal securities cases to minimize uncertainty and time consuming litigation within lower federal courts.

It is difficult to consider a limitations statute that better serves the important federal policies at stake and considers the practicalities of litigation in a case based on the Securities Exchange Act of 1934 than those provisions in the 1934 Act

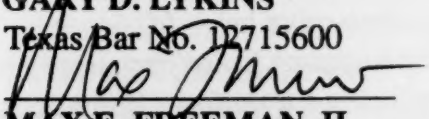
itself that explicitly and expressly state such a period. Adopting and implementing this approach will create predictability within the circuits and consistency among the states. By adopting a single federal limitations period for each cause of action under federal securities laws, plaintiffs and defendants alike would receive equal treatment under the same federal statute (regardless of forum).

Application of the appropriate period of limitations to the facts of this case bars Respondents' claims of alleged violations of federal securities laws, as a matter of law.

For these reasons, a writ should issue to review the decision of the Court of Appeals for the Fifth Circuit.

Respectfully submitted,

**ROBERT R. ROBY**
Texas Bar No. 17118800
**GARY D. LYKINS**
Texas Bar No. 12715600



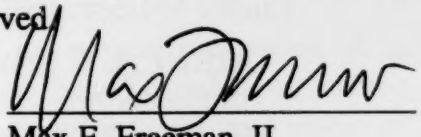
**MAX E. FREEMAN, II**
Texas Bar No. 07427000
*(Counsel of Record)*
**GWINN & ROBY**
4100 Renaissance Tower
1201 Elm Street
Dallas, Texas 75270
(214) 698-4100

**STEPHEN R. KIRKLIN**
Texas Bar No. 11523700
**JACK J. GARLAND, JR.**
Texas Bar No. 07668900
**JACK CHAPLINE VAUGHAN, JR.**
Texas Bar No. 20507100

**KIRKLIN & BOUDREAUX**
1800 InterFirst Plaza
Houston, Texas 77002
(713) 757-0000
***ATTORNEYS FOR PETITIONERS, VENITA VANCASPEL and VANCASPEL & CO., INC.***

## CERTIFICATE OF SERVICE

I hereby certify that on this 21 day of July 1988, three copies of the Petition for Writ of Certiorari were mailed, postage prepaid, to Michael S. Tomasic, Esq., 1800 Augusta Drive, Suite 232, Houston, Texas, 77057, counsel for the Respondent. I furthur certify that all parties required to be served have been served.

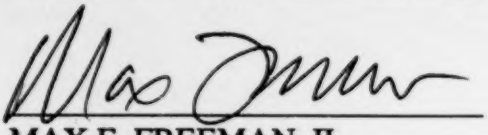


Max E. Freeman, II
*(Counsel of Record)*
GWINN & ROBY
4100 Renaissance Tower
1201 Elm Street
Dallas, Texas 75270
(214)698-4100

*Counsel for Petitioners,*
*Venita VanCaspel and*
*VanCaspel & Co., Inc.*

## CERTIFICATE OF MEMBERSHIP

It is hereby certified that all of the attorneys whose names appear below are members of the bar of this Court.



MAX E. FREEMAN, II

STEPHEN R. KIRKLIN

No.

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*Petitioners,*
v.
CHARLES T. CORWIN, D.D.S., *et al.*
*Respondents.*

## APPENDIX

Robert R. Roby, Esq.
Gary D. Lykins, Esq.
Max E. Freeman, II, Esq.
*(Counsel of Record)*
GWINN & ROBY
4100 Renaissance Tower
1201 Elm Street
Dallas, Texas 75270

Stephen R. Kirklin, Esq.
Jack J. Garland, Esq.
Jack Chapline Vaughan, Jr., Esq.
KIRKLIN & BOUDREAUX
1800 InterFirst Plaza
Houston, Texas 77002

*Counsel for Petitioners, Venita VanCaspel and VanCaspel & Co., Inc.*

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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NO. 87-2771

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CHARLES T. CORWIN, D.D.S., *et al.*
*Plaintiffs-Appellants,*
v.
MARNEY, ORTON INVESTMENTS, a
General Partnership, *et al.*
*Defendants-Appellees.*

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On Appeal from the United States
District Court for the Southern
District of Texas
Argued: January 5, 1988
Before: THORNBERRY, GEE, and
POLITZ, *Circuit Judges.*
(Filed April 26, 1988)

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Michael S. Tomasic, Esq.
ATTORNEY AT LAW
1800 Augusta Drive
Suite 232
Houston, Texas 77057
*Attorney for Appellant*

Larry R. Veselka, Esq.
David Lamb, Esq.
VINSON & ELKINS
3300 First City Tower
1001 Fannin Street
Houston, Texas 77002-6760
*Attorneys for Marney*

John A. Irvine, Esq.

BOYAR, NORTON & BLAIR
Five Post Oak Park
Houston, Texas 77027
*Attorneys for Sidney Orton*

Stephen R. Kirklin, Esq.
Jack J. Garland, Esq.
KIRKLIN, BOUDREAUX & JOSEPH
1800 InterFirst Plaza
Houston, Texas 77002
*Attorneys for VanCaspel & Co., Inc.*

Robert R. Roby, Esq.
GWINN & ROBY
4100 Renaissance Tower
1201 Elm Street
Dallas, Texas 75270
*Attorneys for Venita VanCaspel*

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## OPINION OF THE COURT

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HOMER THORNBERRY, *Circuit Judge*.

Appellants, investors in a Houston office building project, come to this court for a second time. They sued under the securities laws and the Racketeer Influenced and Corrupt Organizations Act (RICO) when their investment lost money. On their first appeal, we reversed a summary judgment for the defendants, holding that a fact issue existed as to whether limitations had run on the Rule 10b-5 claim. *Corwin v. Marney Orton Investments*, 788 F.2d 1063 (5th Cir.1986) [hereinafter *Corwin I*]. We also reversed the dismissal of the RICO claim and the pendent state-law claims. On remand the district court again dismissed all claims. On summary judgment, the district court again held the Rule 10b-5 and RICO claims barred by the statute of

limitations and exercised its discretion to dismiss the pendent state-law claims. We reverse.

## I. FACTS

On this appeal from summary judgment, we must view the facts in the light most favorable to the appellants. *Prinzi v. Keydril Co.*, 788 F.2d 707, 709 (5th Cir. 1984). The facts, viewed in this light, were fully set forth in *Corwin I*. We repeat those facts that are relevant to this appeal.

Marney, Orton Investments, a general partnership composed of Ronald D. Marney and Sidney Orton, prepared a lengthy set of documents entitled "Confidential Private Offering Memorandum" to be sent to several individuals in Texas. This memorandum, dated November 1, 1980, offered investment opportunities in twenty-one units of a limited partnership known as the Woodway III Office Building, Ltd. ("the building partnership"). The general partner in the building partnership was Marney, Orton Investments. Each limited partnership unit was priced at $60,000. Marney, Orton Investments formed the building partnership to own, devlop, and operate a professional office building on a certain tract of land on Woodway Drive in Houston. Another limited partnership, Woodway III, Ltd. ("the land partnership") had contributed this tract to the building partnership in exchange for nine limited partnership units in the building partnership.

Charles T. Corwin and six others received this offering memorandum and each decided to invest. The six investors other than Corwin recieved information and advice from Venita VanCaspel, principal owner and chief executive officer of VanCaspel & Company, Inc., who promoted these investments and received commissions on the funds invested. Each of the seven investors purchased one unit of the

building partnerhsip in December 1980, paying $30,000 in cash and signing a note for another $30,000 payable in November 1981. Each investor paid the note when due. Marney, Orton Investments made two "cash calls" of approximately $17,000 each in 1983 and 1984 and each of the investors responded. Thus, each investor made a total investment of about $94,000.

After the building was completed Corwin became dissatisfied and hired an accountant, James R. Ferrel, to review the records of the building partnerhsip. Ferrel's review began on May 2, 1984 but was halted on July 31, 1984 when he was denied further access to records. From his partial investigation, Ferrel concluded that the land partnership's true equity in the contributed property was not fully disclosed by the offering memorandum. Ferrel also found that various construction and finishing costs were higher than stated in the offering memorandum and that various instances of managerial malfeasance had occurred, including undisclosed rent concessions to certian tenants and undisclosed payments to certain entities related to Marney, Orton Investments. Corwin also discovered that VanCaspel owned a substantial portion of the land partnership at the time she was promoting investment in the building partnership.

Corwin and the six other investors filed suit in federal district court on September 4, 1984. This was less than four years after the date on the offering memorandum and the date of their investments. Named as defendants were Marney, Orton Investments, the estate of Ronald D. Marney, Suzanne M. Marney, MOH, Inc. and Marney Properties, Inc. (two Texas corporations originally owned by Marney and Orton that sold interests in the building partnership and managed its property), Sidney Orton, Venita VanCaspel, and VanCaspel and Company. The complaint charged the defendants with

violations of the Securities Act of 1933, sections 5(a), 5(c), 12(2), and 17(a), 15 U.S.C. §§ 77e(a), (c), 77l(2), 77q(a). The complaint also charged violations of the Securities Exchange Act of 1934, sections 10(b), 15 U.S.C. §§ 78j(b), and 20(a), 15 U.S.C. § 78*t*(a), and Rule 10b-5. The complaint in addition included a RICO claim, with alleged predicate acts of federal and state securities law violations, federal mail fraud, and various Texas criminal statutes. Finally, the complaint alleged various pendent state law claims.

The district court originally granted the defendants' motion for summary judgment, dismissing all of the plaintiffs' claims. In *Corwin I*, we affirmed the district court except as to the dismissal of the claims under section 10(b), Rule 10b-5, RICO and the state-law claims. 788 F.2d at 1069. We remanded those claims to the district court for further proceedings.

Following our remand, the defendants again moved for summary judgment. The plaintiffs responded with a motion for a continuance. The plaintiffs asserted that pursuant to a prior order, they had taken no discovery since the remand. Additionally, the plaintiffs noted that defendents' counsel, Larry Veselka, had agreed to advise the plaintiffs of which allegations in the complaint the defendants intended to contest so that the plaintiffs could prepare an amended complaint. Also, Mr. Veselka had agreed that an amended complaint was necessary, because *Corwin I* had affirmed the dismissal of several of the claims in the original complaint. The plaintiffs also filed a response to the motion for summary judgment. Thereafter, the plaintiffs filed a motion to amend their complaint. The district court denied this motion.

The plaintiffs then filed affidavits to be used as summary judgment evidence. The parties were given an

opportunity for an "evidentiary hearing," but they all agreed that a hearing was unnecessary because "all the facts necessary for a complete and just adjudication were before the Court." The district court then granted summary judgment for the defendants. The court held that the plaintiffs should have discovered the misleading statements and omissions by December 1980, thus barring their securities claims under the applicable two-year statute of limitations. Next, the court held that the RICO claim was barred under a two-year statute of limitations as the most analogous state statute. Finally, the court dismissed without prejudice the state-law claims.

The plaintiffs appealed.

## II. SECURITIES LIMITATIONS

The appropriate limiations period for the Rule 10b-5 claims in Texas is two years. *Wood v. Combustion Engineering, Inc.*, 643 F.2d 339, 346 (5th Cir. 1981). The limitations period, however, does not begin to run until the plaintiffs have discovered, or reasonably should have discovered, the defendants' alleged misdeeds. *Breen v. Centex Corp.*, 695 F.2d 907, 911 (5th Cir. 1983). On summary judgment, the district court held that the plaintiffs should have discovered any misleading or omitted statements by December 1980, and it dismissed the claims.

In *Corwin I* we noted that the plaintiffs had alleged and supported their contention that they did not know of the 10b-5 violations until Ferrel's audit, which occurred within the two-year time limit. 788 F.2d at 1069. Thus, the plaintiffs had raised a genuine issue of material fact on the issue of their actual knowledge of the alleged misdeeds. We will not reconsider this earlier determination. On the question of when the plaintiffs discovered the alleged

misleading or omitted information, there exists an issue of fact. Unless this claim can be disposed of on another issue, a trial is required to determine when the plaintiffs discovered the improper information.

Even if the plaintiffs had no actual knowledge of the information, however, the limitations period would begin if the plaintiffs should have known of the misleading or omitted statements. In *Corwin I* we said that, if the offering memorandum and supporting documents were misleading or fraudulent, it was not clear when the plaintiffs should have made this discovery. *Id.* at 1068-69. We said this because the defendants had not presented any evidence on the should-have-known question. Additionally, we stated that "[o]ther than the initial offering memorandum and supporting documents, the defendants have identified no communications or occurrences which would have alerted the suspicions of a reasonably diligent investor." *Id.* at 1069. This statement, accompanied by our reversal of the summary judgment, implied that the initial offering memorandum and supporting documents were insufficient for a finding against the plaintiffs on this issue on summary judgment. We did, however, leave room for the defendants, after the remand, to produce evidence of other communications or occurrences that would have alerted the suspicions of a reasonably diligent investor. Thus, we did not foreclose the possibility of new evidence allowing summary judgment on the limitations question based on when the plaintiffs should have discovered the alleged misstatements and omissions.

The only evidence the defendants now adduce to support their summary judgment--other than the initial offering memorandum and supporting documents--are some records filed with the state of Texas. The most important of these records is a document filed with the Texas Secretary of State disclosing Venita VanCaspel's ownership in the land

partnership. The defendants argue that because Texas law often imputes constructive knowledge of information that could have been obtained from public records, *Sherman v. Sipper*, 137 Tex. 85, 152 S.W.2d 319, 321 (1941), the plaintiffs, as a matter of law, should have known of the information contained in these records. Thus, they argue the defendants should be barred by limitations from asserting any claims based on Venita VanCaspel's ownership interest.

Although the federal securities laws borrow statutes of limitations from state law, federal law determines when the limitations periods begin to run. *Corwin I*, 788 F.2d at 1068; *Breen v. Centex Corp.*, 695 F.2d 907, 911 (5th Cir.1983). It is federal law that imposes the discovery rule, and thus federal law should determine what circumstances and information should alert the suspicions of a reasonably diligent investor.

We cannot say as a matter of law that a reasonably diligent investor would look to all state records of which the investor might later, for some purposes, be charged with constructive knowledge. *See Briskin v. Ernst & Ernst*, 589 F.2d 1363, 1368 (9th Cir.1978)(holding that a question of fact existed on whether a reasonably prudent person would check an SEC registration statement). It seems plausible to us that a reasonable investor could rely on the offering memorandum, the supporting documents, and discussions with the promoter to disclose a promoter's ownership interest in the investment. Although the fact that a state law will impose knowledge on an investor for state-law purposes may be considered in determining what investigations a reasonable investor would make, that fact alone is not sufficient to take the reasonableness issue from the hands of the fact finder.

It is true that there may be unusual circumstances that would alert an investor to begin a much more careful

investigation of the investment than he ordinarily would undertake. *Cf. Westchester Corp. v. Peat, Marwick, Mitchell & Co.*, 626 F.2d 1212, 1217-18 (5th Cir.1980)(holding that plaintiffs had duty to investigate when they knew that auditors had withdrawn financial statement certification as a result of errors, that auditors had asked to withdraw from the audit unless released from liability, that the auditors were dismissed, and that two lawsuits had been filed alleging fraudulent financial statements). However, absent undisputed summary judgment evidence of such circumstances, summary judgment on the should-have-known question because of information external to that ordinarily used by investors should be rare. In the current case, the investors did not have knowledge of facts that would require them, acting as reasonably prudent investors, to investigate VanCaspel's ownership interests. *See id.* at 1217. They apparently had no suggestion that VanCaspel owned a substantial part of the land partnership until some time after Ferrel's audit.

In summary, we hold that a state law that imposes constructive knowledge of certain records for state-law purposes is, by itself, insufficient for finding as a matter of law that an investor "should have known" of the information in those records for federal securities law limitations purposes. An investor without reason to know of something untoward in the circumstances of the investment is not necessarily burdened with a duty to examine documents external to those normally used in the transaction. Normally, a fact issue will exist about whether a reasonably prudent

investor would undertake such an external examination. There is no undisputed summary judgment evidence of unusual circumstances in this case that would clearly trigger a duty to investigate Ventia VanCaspel's ownership in the land or the partnership. Therefore, although the fact finder might later determine that the plaintiffs should have known of VanCaspel's interests, summary judgment on that fact issue was improper. [1]

## III. RICO LIMITATIONS

The district court, applying a two-year statute of limitations to the RICO claim, dismissed the plaintiffs' RICO claim. Since the trial, the Supreme Court has decided *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, ___ U.S. ___, 107 S.Ct. 2759, 97 L.Ed.2d 121 (1987). That case held that a four-year limitations period applied to civil RICO claims. *Id.*, 107 S.Ct. at 2767. Thus, we must reverse the district court's RICO limitations dismissal. [2]

## IV. AMENDING THE COMPLAINT

At a chambers conference after the first remand, the district court denied the investors' motion for leave to amend

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[1] The defendants also contend, as they did in the district court and on the first appeal, that the plaintiffs' securities claims fail as a matter of substantive securities law. *See Corwin I*, 788 F.2d at 1069 n. 5. They urge us to consider those issues in this appeal. The district court has not passed on the merits of the substantive claims, and we feel that these issues should be first considered by the district court. Thus, we express no opinion on the merits of the plaintiffs' substantive claims.

[2] As in the first appeal, we decline the defendants' invitation to proceed to the merits of the RICO claims. *See Corwin I*, 788 F.2.d at 1069 n.6. Nothing has changed since the first appeal. The district court still has not reached these substantive issues.

their complaint and to conduct further discovery. The investors contend that this denial amounted to an abuse of the trial court's discretion. They point to a letter they received a few weeks before the trial court denied their motion. The letter was from Marney Orton's counsel and stated that because of the prior appeal, an amended complaint would be necessary so that the defendants could determine which claims remained material to the case. The investors point to Federal Rule of Civil Procedure 15(a), which says that "a party may amend the party's pleading only by leave of the court *or by written consent of the adverse party*" (emphasis added).

It is clear that the district court's decision denying the amendment should not be reversed absent an abuse of discretion. *See, e.g., Wedgeworth v. Fiberboard Corp.*, 706 F.2d 541, 546 (5th Cir.1983); *Addington v. Farmer's Elevator Mutual Ins. Co.*, 650 F.2d 663, 666 (5th Cir. Unit A 1981). In exercising its discretion, the district court is to consider various factors, including undue prejudice to the opposing party, and futility of the amendment. *Addington,* 650 F.2d at 666. However, although our reviewing standard is abuse of discretion, "the policy of liberal amendment directs that 'unless there is a substantial reason to deny leave to amend, the discretion of the district court is not broad enough to permit denial.'" *Wedgeworth,* 706 F.2d at 546 (quoting *Dussouy v. Gulf Coast Investment Corp.*, 660 F.2d 594, 598 (5th Cir.1981)).

In this case we believe that the district court abused its discretion. Rule 15(a) clearly contemplates agreement of the opposing party as an independent reason for granting leave to amend. Although the defendants now assert that the motion was properly denied because of undue delay, dilatory motive, undue prejudice, and futility, their assertion is weakened by their letter's clear expression of acquiescence to an

amendment, and their statement in the letter that an amendment would be for their own benefit. The defendants agreed to an amended complaint, and Rule 15(a) requires that they remain bound by that agreement. Therefore, we reverse the denial of the investors' motion for leave to amend their complaint.

## V. DISCOVERY

Prior to the first appeal, the trial judge entered an order restricting discovery to those matters relating to the defendants' motion to dismiss. This order is still in effect. Thus, the investors have not yet taken any substantial discovery. After the first remand, the investors moved for an opportunity to take further discovery.

Prior to granting the defendants' motion for summary judgment, the district court offered the parties the opportunity for an "evidentiary hearing" on those issues relevant to the motion. All parties agreed, however, that a hearing was unnecessary, because "all facts necessary for a complete and just adjudication were before the court." [3] The court denied the investors' motion and granted summary judgment for the defendants.

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[3] After reviewing the record, we remain unsure about why the judge and the parties were discussing an evidentiary hearing at the time the judge was considering a motion for summary judgment. Live testimony is not considered on summary judgment. *See* Fed.R.Civ.P. 56(c). There is nothing in the record indicating that the parties agreed to try the case on the cross motions for summary judgment. In fact, the plaintiffs never moved for their own summary judgment. Additionally, in the district court the parties frequently referred to the existence or lack of "summary judgment evidence." The parties apparently considered the motion to be only an ordinary motion for summary judgment. We therefore consider these statements only insofar as they relate to whether the plaintiffs waived further discovery by agreeing that the court had all the facts necessary for a complete adjudication.

The district court has broad discretion in limiting discovery. *Mayo v. Tri-Bell Industries, Inc.*, 787 F.2d 1007, 1012 (5th Cir. 1986). Its rulings will be reversed only when arbitrary or clearly unreasonable. *Id.* More specifically, we have held that a trial court may properly exercise its discretion to stay discovery pending a decision on a dispositive motion. *Scroggins v. Air Cargo, Inc.*, 534 F.2d 1124, 1133 (5th Cir. 1976). It would be wasteful to allow discovery on all issues raised in a broad complaint when, for example, the case will not reach trial because of the expiration of a limitations period.

We cannot say that the district court abused its discretion in this case, especially in light of the parties' agreement that the court had all necessary facts before it. The investors argue that all that was meant by the agreement was that they believed they had enough summary judgment evidence to create a fact issue and defeat the summary judgment. As it turns out, the investors were, at least partially, correct in their belief. At least with respect to the limitations questions, no further discovery was necessary to defeat the defendants' motion. Of course, the district court will likely grant an opportunity for more discovery if a trial on the merits is required, and the court may want to allow more discovery in light of the investors' amended complaint. Further, because the court erroneously believed limitations to be the dispositive issue, it may want to exercise its discretion to allow additional discovery before deciding the summary judgment motion regarding the substantative claims. However, these decisions are left to the district court on remand.

## VI. PENDENT STATE-LAW CLAIMS

When the district court dismissed the federal claims, it also dismissed the pendent state-law claims. A trial court has wide discretion in deciding whether to retain jurisdiction over pendent claims after disposing of the federal claims that created jurisdiction. *United States v. Capeletti Brothers, Inc.*, 621 F.2d 1309, 1317-18 (5th Cir. 1980). If, however, the federal claims are dismissed before trial, the state claims normally should be dismissed as well. *United Mine Workers v. Gibbs*, 383 U.S. 715, 86 S.Ct. 1130, 1139, 16 L.Ed.2d 218 (1966); *Corwin I*, 788 F.2d at 1069.

As in *Corwin I*, we determine that the district court erroneously dismissed the securities and RICO claims. Thus, the district court's premise for dismissing the state claims was incorrect. For this reason, we reverse the dismissal of the state claims. In so ruling, we express no opinion on the merits of these state claims.

## VII. CONCLUSION

For the reasons set forth in this opinion, the judgment of the district court is REVERSED. The case is REMANDED for proceedings consistent with this opinion.

**BY THE COURT**

*/s/ Homer Thornberry*
Homer Thornberry
*Circuit Judge*

Dated: April 26, 1988

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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NO. 87-2771

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CHARLES T. CORWIN, D.D.S., *et al.*
*Plaintiffs-Appellants,*
v.
MARNEY, ORTON INVESTMENTS, a
General Partnership, *et al.*
*Defendants-Appellees.*

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Appeal from the United States
District Court for the Southern
District of Texas

ORDER:

IT IS ORDERED that the motion of appellees, Venita VanCaspel and VanCaspel & Co., Inc., for leave to file petition for rehearing out of time is GRANTED.

*/s/ Thomas Gibbs Gee*
Thomas Gibbs Gee,
*United States Circuit Judge*

Dated: June 3, 1988

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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NO. H-87-2771

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CHARLES T. CORWIN, D.D.S.; The Estate of RICHARD P. MULLINS, Deceased; DONALD T. BOUDREAUX and PATRICIA E. BOUDREAUX, his wife; DAVID T. CARR, M.D. and CHRISTINE N. CARR, his wife; JOHN D. DICKERSON, JR. and JOAN W. DICKERSON, his wife; HAROLD O. HUDNALL and AUDREY S. HUDNALL, his wife; and ROBERT EMERSON CRATON and MARY JANET CRATON, his wife,

*Appellants,*

vs.

MARNEY, ORTON INVESTMENTS, a General Partnership; The Estate of RONALD D. MARNEY, Deceased; SIDNEY ORTON; MOH, INC.; VENITA VANCASPEL; VANCASPEL & CO., INC.; MARNEY PROPERTIES, INC.; and SUZANNE M. MARNEY,

*Appellees.*

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
(DISTRICT COURT CAUSE NO. H-84-3689)
HONORABLE ROSS N. STERLING, *JUDGE PRESIDING*

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JOINT PETITION FOR REHEARING ON BEHALF OF APPELLEE VENITA VANCASPEL AND APPELLEE VANCASPEL & CO., INC.

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GWINN & ROBY
ROBERT R. ROBY
GARY D. LYKINS
4100 Renaissance Tower
1201 Elm Street
Dallas, Texas 75270

KIRKLIN, BOUDREAUX & JOSEPH
STEPHEN R. KIRKLIN
JACK J. GARLAND, JR.
1800 InterFirst Plaza
1100 Louisiana
Houston, Texas 77002

The undersigned counsel of record certifies that the following listed persons have an interest in the outcome of this case. These representatives are made in order that the Judges of this Court may evaluate possible disqualification or recusal.

Charles T. Corwin, D.D.S.
The Estate of Richard P. Mullins, Deceased
Donald T. Boudreaux, and wife Patricia E. Boudreaux
David T. Carr, M.D., and wife Christine N. Carr
John D. Dickerson, Jr., and wife Joan W. Dickerson
Harold O. Hudnall, and wife Audrey S. Hudnall
Robert Emerson Craton, and wife Mary Janet Craton
Marney, Orton Investments, a General Parntership
The Estate of Ronald D. Marney, Deceased
Sidney Orton
MOH, Inc.
Venita VanCaspel
VanCaspel & Co., Inc.
Marney Properties, Inc.
Suzanne M. Marney

/s/ Robert R. Roby
Robert R. Roby

*COUNSEL TO APPELLEE VENITA VANCASPEL*

*/s/ Stephen R. Kirklin*
Stephen R. Kirklin

*COUNSEL TO APPELLEE VANCASPEL & CO., INC.*

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## TABLE OF AUTHORITIES



### STATUTES AND RULES

## STATEMENT OF JURISIDICTION

This Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 1291, as an appeal from the final decision of the United States District Court for the Southern District of Texas.

## STATEMENT OF ISSUES

1. In light of the United States Supreme Court's opinion of *Agency Holding Corporation v. Malley-Duffy & Associates, Inc.*, ____ U.S. ____; 107 S.Ct. 2759; 97 L.Ed.2d 121 (1987) 15 U.S.C. § 78*r*(*c*) or § 13 of the Securities Act of 1933, 15 U.S.C. § 77*m* would be the most analogous statute of limitations to be applied to private causes of action for violations of federal securities laws found in the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder as held by the Third Circuit Court of Appeals in their opinion of *In Re Data Access Systems Securities Litigation*, ___ F.2d ___; 1988 WL 30879 (3rd Cir.N.J.)?

2. If Appellants' claims are governed by 15 U.S.C. § 78*r*(*c*) or 15 U.S.C. § 77*m*, are Appellants' claims barred by limitations?

## STATEMENT OF THE CASE

### A. *PROCEDURAL HISTORY*

This suit is before this Court a second time after rendition of a summary judgment by the District Court in favor of Appellees on the basis of limitations. Appellants filed suit in Federal District Court on September 4, 1984 charging Appellees with violations of the Securities Act of 1933, the Securities Exchange Act of 1934 and the Racketeer Influenced and Corrupt Organizations Act ("RICO") by reason of the alleged securities-fraud violations. Various state law claims were also alleged.

On appeal for the first time, this Court affirmed the dismissals of claims under the Securities Act of 1933 and the Investment Advisors Act of 1940, but reversed the dismissals of the Rule 10b-5 and RICO claims along with state-law claims, remanding the case for proceedings consistent with its opinion. *Corwin v. Marney, Orton, Inv.*, 788 F.2d 1063 (5th Cir. 1986). This Court suggested that the District Court should determine when the Appellants discovered or reasonably should have discovered the basis of their claims in order to determine when the two-year period of limitations began to run for Rule 10b-5 claims in Texas, having held the Texas two-year statute of limitations for fraud to be the most analogous statute to be applied to such causes of action.

On remand, Appellees took discovery and filed motions for summary judgments on the basis that the securities-fraud claims were barred by limitations. The District Court considered Appellants' claims, heard the relevant evidence tendered by all parties and determined that Appellants knew or should have known the basis of their claims more than two

years prior to September 4, 1984 - the date Appellants initiated this action.

## B. *STATEMENT OF FACTS*

This case involves disputes over Appellants' investment in a tax sheltered, limited partnership having as its purpose the building, operating and selling of a commercial office building in Houston, Texas. Appellants all purchased limited partnership interests in such tax sheltered limited partnership. Appellants placed their money in this tax sheltered limited partnership in December 1980. Appellants' claims generally relate to alleged misrepresentations and alleged omissions of material facts. Appellants filed suit September 4, 1984.

## SUMMARY OF ARGUMENT

In this Court's opinion of April 26, 1988, this Court assumed the appropriate limitations for Rule 10b-5 claims and other violations of federal securities laws to be governed by the Texas two-year statute of limitations applicable to fraud claims, having previously determined the same to be the most analogous statute of limitations to be applied.

In light of the Supreme Court's opinion in *Agency Holding Corporation v. Malley-Duff & Associates, Inc.*, ____ U.S. ___, 107 S.Ct. 2759, 97 L.Ed.2d 121 (1987), this Court should reconsider (as did the Third Circuit sitting *en banc*) the most analogous statute of limitations to be applied to such causes of action and should hold, based upon public policy to be served and the legislative history underlying the federal securities laws, that the federal statutes of limitations contained within the federal securities laws to be the most analogous statute of limitations. Such a determination by

this Court would be consistent with the Third Circuit (sitting *en banc*) determination and reasoning set forth in their opinion of *In Re Data Access Systems Securities Litigation*, ____ F.2d ____; 1988 WL 30879 (3rd Cir. N.J.).

Having thus determined the federal statute to be most analogous, Appellants' claims for violations of federal securities laws would be barred because they were not brought within three years from the date of purchase (the longest possible period of time to file suit according to the federal statute of limitations).

## ARGUMENT AND AUTHORITIES

### I. *APPELLANTS' CLAIMS FOR VIOLATIONS OF FEDERAL SECURITIES LAWS ARE GOVERNED BY THE SECURITIES EXCHANGE ACT OF 1934 §78r(c).*

In this Court's opinion of April 26, 1988, this Court assumed the appropriate limitations for the Rule 10b-5 claims in Texas to be two years and further held that such period of limitations does not begin to run until the Appellants have discovered, or reasonably should have discovered, the Appellees' alleged misdeeds. Because of this holding, the Court reasoned that Appellants had raised a genuine issue of material fact on the issue of their actual knowledge of the alleged misdeeds and stated "unless this claim can be disposed of on another issue, a trial is required to determine when the Plaintiffs discovered the improper information."

Appellees contend this Court should apply a different period of limitations as the most analogous statute of limitations to be applied. Under the Third Circuit's opinion of *In Re Data Access Systems Securities Litigation*, the

applicable period of limitations to be applied to violations of federal securities laws, including violations of Rule 10b-5, is governed by a federal statute more analogous to the cause of action than any statute of limitations borrowed from state law. Following the United States Supreme Court's direction set forth in *Agency Holding Corporation v. Malley-Duff & Associates, Inc.*, ____ U.S. _____; 107 S.Ct. 2759; 97 L.Ed.2d 121 (1987), the Third Circuit reasoned, *en banc*, that because there is an absence of a uniform limitations period in actions alleging violations of federal securities laws which have been sources of troublesome and vexing aggrevation on the part of trial practitioners and legal scholars, public policy and the need for uniform decisions require borrowing another federal statute as the most analogous statute of limitations to be applied. The Third Circuit also noted that "the Courts of Appeals disagree on every possible question about limitations periods in securities cases." *In Re Data Access Systems*, at _____. The Third Circuit then reviewed the applicable period of limitations to be applied to causes of action alleging violations of federal securities laws in light of *Agency Holding Corporation* decided by the United States Supreme Court. The Third Circuit concluded that the federal scheme of limitations expressly set forth in the Securities Exchange Act of 1934 "clearly provides a closer analogy than available state statutes" and that the "federal policies at stake [in 10(b) and Rule 10b-5 actions] and the practicalities of litigation make the [the federal] rule a significantly more appropriate vehicle for interstitial law making" especially because of the wide discrepancies in analogous state statutes of limitations. *Data Access* at _____.

Thus borrowing the analogous federal statute of limitations and applying the same to private causes of action brought under federal securities laws, the Third Circuit held that "no action shall be maintained to enforce any liability

[for manipulating security prices] unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." *Data Access* at _____. The Court further held "no action shall be maintained to enforce any liability [for misleading statements in any application, report, or filed document] unless brought within one year after the discovery of the facts constituting the cause of action and within three years after which such cause of action occurred."

Such holding would be dispositive of the investors' claims asserting violations of federal securities laws in the case presently before this honorable Court. The public policy and legislative history supporting the application of the federal statute of limitations to federal securities claims has been eloquently set forth by the Third Circuit sitting *en banc*. In short, the Third Circuit held (by applying the more analogous federal statute of limitations) that an investor must bring a cause of action under federal securities laws within one year from the date of discovery or within three years from the date of purchase, whichever is greater. Thus, the three year bar of limitations from the date of purchase is absolute without any tolling provision. Thus applying the reasoning of the Third Circuit to the facts presently before this Court it cannot be disputed that more than three years have elapsed between the date the investors acquired their securities and the date the investors filed suit. Therefore, as a matter of law, the Appellants' claims asserting violations of federal securities laws are barred by the appropriate period of limitations as set forth by the Third Circuit in *Data Access*.

Appellees do not challenge the Court's reversal of the dismissal for claims asserted under RICO in light of the Supreme Court's application of a four year statute of limitations (also applying a federal statute of limitations as the most analogous statute of limitations for public policy

reasons) set forth in *Agency Holding Corporation v. Malley-Duff & Associates, Inc.* ____ U.S. _____; 107 S.Ct. 2759; 97 L.Ed.2d 121 (1987).

II. *APPELLANTS' CLAIMS FOR VIOLATIONS OF FEDERAL SECURITIES LAWS AND VIOLATIONS OF RULE 10b-5 ARE BARRED BY LIMITATIONS.*

Appellants filed suit on September 4, 1984. It is undisputed that Appellants purchased their securities in December of 1980. Assuming the longest possible time frame for Appellants to have filed suit within (three years from the date of purchase), Appellants' claims for violations of federal securities laws and Rule 10b-5 are barred as a matter of law. 15 U.S.C. § 78*r*(*c*); 15 U.S.C. § 77*m*.

## CONCLUSION

The federal scheme of limitations expressly set forth in the Securities Exchange Act of 1934, 15 U.S.C. § 78*r*(*c*), or 13 of the Securities Act of 1933, 15 U.S.C. § 77*m* clearly provides a closer analogy than available state statutes for complaints alleging violations of federal securities laws and violations of Rule 10b-5 promulgated thereunder. Therefore, Appellants' claims asserting violations of federal securities laws and Rule 10b-5 are barred as a matter of law.

## PRAYER

WHEREFORE, PREMISES CONSIDERED, Appellee Venita VanCaspel and Appellee Vancaspel & Co., Inc. respectfully request this Court withdraw its opinion rendered April 26, 1988 in this matter and address the issues set forth herein in light of the recent U.S. Supreme Court and Third Circuit opinions cited herein.

CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the above and foregoing Petition for Rehearing was forwarded via certified mail, return receipt requested to all interested parties on this ____ day of _____, 1988.

*/s/ Robert R. Roby*
Robert R. Roby

COUNSEL FOR APPELLEE VENITA *VANCASPEL*

*/s/ Stephen R. Kirklin*
Stephen R. Kirklin

*COUNSEL FOR VANCASPEL & CO., INC.*

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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NO. 87-2771

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CHARLES T. CORWIN, D.D.S., *et al.*,
*Plaintiffs-Appellants,*
v.
MARNEY, ORTON INVESTMENTS, a
General Partnership, *et al.*,
*Defendants-Appellees.*

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Appeal from the United States
District Court for the Southern
District of Texas

ON PETITION FOR REHEARING

(Filed June 3, 1988)

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Before: THORNBERRY, GEE, and
POLITZ, *Circuit Judges.*

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*PER CURIAM:*

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby DENIED.

**ENTERED FOR THE COURT**

*/s/ Thomas Gibbs Gee*
Thomas Gibbs Gee,
*United States Circuit Judge*

Dated: June 3, 1988

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| CHARLES T. CORWIN, D.D.S.; | § | |
| THE ESTATES OF RICHARD P. | § | |
| MULLINS, DECEASED; DONALD T. | § | |
| BOUDREAUX AND PATRICIA E. | § | |
| BOUDREAUX, HIS WIFE; DAVID T. | § | |
| CARR, M.D. AND CHRISTINE N. | § | |
| CARR, HIS WIFE; JOHN D. | § | |
| DICKERSON, JR. AND JOAN W. | § | |
| DICKERSON, HIS WIFE; | § | |
| HAROLD O. HUDNALL AND | § | |
| AUDREY S. HUDNALL, HIS WIFE; | § | |
| AND ROBERT EMERSON CRATON | § | |
| AND MARY JANET CRATON, HIS WIFE; | § | —. |
| | § | |
| *Plaintiffs,* | § | NO. H-84-3689 |
| v. | § | |
| | § | |
| MARNEY, ORTON INVESTMENTS, | § | |
| A GENERAL PARTNERSHIP; THE | § | |
| ESTATE OF RONALD D. MARNEY, | § | |
| DECEASED; SIDNEY ORTON; MOH, | § | |
| INC.; VENITA VANCASPEL; VANCASPEL | § | |
| & CO., INCORPORATED; MARNEY | § | |
| PROPERTIES, INC.; AND | § | |
| SUZANN M. MARNEY, | § | |
| | § | |
| *Defendants.* | | |

## SUMMARY JUDGMENT AND ORDER

Came on to be heard the motion for summary judgment on complaint and for partial summary judgment on counterclaim of Defendants/Counterclaimants Venita VanCaspel and VanCaspel & Co., Incorporated, and the Joint Motion for Summary Judgment of Marney/Orton Defendants. The parties were given the opportunity for an evidentiary hearing, but all parties agreed that there was no need for such evidentiary hearing because all the facts necessary for a complete and just adjudication were before the Court. The Court having considered same, and the plaintiffs' responses to said motions, the judicial admissions, the affidavits on file, and argument of counsel, the Court finds:

That plaintiffs knew, or by the exercise of reasonable diligence, could and should have known of the statements and omissions that plaintiffs now contend were materially misleading with regard to the subject transaction no later than December of 1980; that the plaintiffs did not file their action until September of 1984, almost four years thereafter; that, as a result of the above factual findings, the court finds that plaintiffs' claims under Section 10(b) of the Securities and Exchange Act of 1934 and under Rule 10b-5 promulgated pursuant thereto, are barred by the two-year statute of limitations found applicable to such actions by the Fifth Circuit in its previous consideration of this matter, *Corwin v. Marney, Orton Investments,* 788 F.2d 1063 (5th Cir. 1986); and that plaintiffs' claims under the Racketeer Influenced and Corrupt Organizations Act is also governed by the two-year statute of limitations as the most analogous state statute, especially since, as admitted at oral argument by plaintiffs' counsel, the gravamen of the plaintiffs' complaint is the Federal Securities Fraud claim under Rule 10b-5, and that

plaintiffs' claims under RICO are therefore similarly barred by limitations; and that it would serve the interest of justice to dismiss the pendent contract and tort claims alleged by plaintiffs and by counter-plaintiffs without prejudice so that they can proceed, if the parties so desire, in the appropriate state court. Therefore, it is

ORDERED:

1. That the motions for summary judgment of defendants Venita VanCaspel and VanCaspel & Co., Inc., and of the Marney/Orton Defendants as to the claims under the Securities and Exchange Act of 1934 and Rule 10b-5 and under RICO are granted and plaintiffs are awarded a take-nothing judgment on those claims, and those claims are hereby dismissed with prejudice;

2. That the pendent state law claims alleged by plaintiffs and by counter-plaintiffs are at the court's discretion dismissed without prejudice and the motions for partial summary judgment as to any of those pendent claims are denied as no longer being before this Court; and

3. That Plaintiffs be taxed all court costs.

SIGNED AND SEALED this 8th day of June, 1987.

*/s/ Ross N. Sterling*
Ross N. Sterling
*United States District Court Judge*

Dated: June 8, 1987.

APPPROVED AS TO FORM:

*/s/ Larry R. Veselka*
Larry R. Veselka
VINSON & ELKINS
1001 Fannin
2604 First City Tower
Houston, Texas 77002-6760
*ATTORNEYS FOR SUZANNE MARNEY*

*/s/ John A. Irvine*
John A. Irvine
Greg A. Bolzle
PORTER & CLEMENTS
700 Louisiana
3500 RepublicBank Center
Houston, Texas 77002
*ATTORNEYS FOR MARNEY, ORTON INVESTMENTS, a General Partnership; THE ESTATE OF RONALD D. MARNEY, DECEASED; and MARNEY PROPERTIES, INC.*

*/s/ Michael S. Tomasic*
Michael S. Tomasic
1800 Augusta Drive
Suite 232
Houston, Texas 77057
*ATTORNEY FOR CHARLES T. CORWIN*

*/s/ Barry Allan Brown*
Barry Allan Brown
GOLDBERG, KUSIN & BROWN
1650 Ben Franklin Tower
5444 Westheimer
Houston, Texas 77056

*/s/ Stephen R. Kirklin*
Stephen R. Kirklin
KIRKLIN, BOUDREAUX & JOSEPH
1800 InterFirst Plaza
Houston, Texas 77002
*ATTORNEYS FOR VENITA VANCASPEL AND VANCASPEL & CO., INC.*

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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NO. 85-2401

---

CHARLES T. CORWIN, D.D.S., *et al.*,
*Plaintiffs-Appellants,*
v.
MARNEY, ORTON INVESTMENTS, a
General Partnership, *et al.*,
*Defendants-Appellees.*

---

On Appeal from the United States
District Court for the Southern
District of Texas
Argued:_____
Before: JOLLY, HILL, *Circuit Judges* and
HUNTER, *District Judge**
(Filed April 30, 1986)

Michael S. Tomasic, Esq.
ATTORNEY AT LAW
1800 Augusta Drive
Suite 232
Houston, Texas 77057
*Attorney for Appellant*

Larry R. Veselka, Esq.
David Lamb, Esq.
VINSON & ELKINS
3300 First City Tower
1001 Fannin Street
Houston, Texas 77002-6760
*Attorneys for Marney*

* District Judge of the Western District of Louisiana, sitting by designation

John A. Irvine, Esq.
BOYAR, NORTON & BLAIR
Five Post Oak Park
Houston, Texas 77027
*Attorneys for Sidney Orton*

Stephen R. Kirklin, Esq.
Jack J. Garland, Jr., Esq.
KIRKLIN, BOUDREAUX & JOSEPH
1800 InterFirst Plaza
Houston, Texas 77002
Houston, Tex.
*Attorneys for VanCaspel & Co., Incorporated*

Robert R. Roby, Esq.
GWINN & ROBY
4100 Renaissance Tower
1201 Elm Street
Dallas, Texas 75270
*Attorneys for Venita VanCaspel*

Before, Jolly and Hill *Circuit Judges*, and HUNTER, *District Judge* ROBERT MADDEN HILL, *Circuit Judge:*

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## OPINION OF THE COURT

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Plaintiff investors lost money in a Houston office building project and sued pursuant to federal securities laws and the Racketeer Influenced and Corrupt Organizations (RICO) Act, 18 U.S.C. §§ 1961-68. The district court properly dismissed most of the securities claims on statute of limitations grounds, but the court erred in dismissing plaintiffs' claim under Rule 10b-5, 17 C.F.R. § 240.10b-5 (1985), because a fact issue existed as to whether limitations had run. We also reverse the district court's dismissal of the RICO claim because the dismissal was based on the absence of an alleged racketeering injury, a requirement recently rejected by the Supreme Court. Finally, we reverse the dismissal of the pendent state claims.

### I. FACTS

Because the district court dismissed this case at a preliminary stage, our initial concern is how we should treat unresolved factual matters. Although the court disposed of the case on defendants' motions to dismiss for failure to state a claim, the court's acceptance of matters outside the pleadings makes such motions more properly treated as ones for summary judgment. *See* Fed.R.Civ.P. 12(b); 5 C. Wright & A. Miller, *Federal Practice and Procedure* § 1366 (1969). On reviewing a summary judgment order, "we must view the evidence and any inferences to be drawn therefrom in the light most favorable to the party moved against to determine whether any genuine issue of material fact exists and whether

the party seeking summary disposition is entitled to judgment as a matter of law." *Prinzi v. Keydril Co.*, 738 F.2d 707, 709 (5th Cir. 1984). For the purposes of this appeal, we therefore relate the following facts in a light most favorable to plaintiffs.

Marney, Orton Investments, a general partnership composed of Ronald D. Marney and Sidney Orton, prepared a lengthy set of documents entitled "Confidential Private Offering Memorandum" to be sent to several individuals in Texas. The offering memorandum, dated November 1, 1980, offered investment opportunities in twenty-one units of a limited partnership known as Woodway III Office Building, Ltd. ("the building partnership"). The general partner in the building partnership was Marney, Orton Investments. Each limited partnership unit was priced at $60,000. Marney, Orton Investments formed the building partnership to own, develop, and operate a professional office building on a certain tract of land on Woodway Drive in Houston. Another limited partnership, Woodway III, Ltd. ("the land partnership") contributed this tract to the building partnership in exchange for nine other limited partnership units in the building partnership.

Charles T. Corwin and six others received this offering memorandum and each decided to invest. The six investors other than Corwin received information and advice from Venita VanCaspel, principal owner and chief executive officer of VanCaspel & Company, Inc. who promoted these investments and received commissions on funds invested. Each of the seven investors purchased one unit of the building partnership in December 1980, paying $30,000 in cash and signing a note for another $30,000 payable in November 1981. Each investor paid his note when due. Marney, Orton Investments made two "cash calls" of approximately $17,000 each in 1983 and 1984 and each of

the investors responded. Thus each investor made a total investment of about $94,000.

After the building was completed Corwin became dissatisfied and hired an accountant, James R. Ferrel, to review the records of the building partnership. Ferrel's review began on May 2, 1984 and halted on July 31, 1984, when he was denied further access to records. Ferrel's partial investigation concluded that the land partnership's true equity in the contributed property was not fully disclosed by the offering memorandum. Ferrel also found that various construction and finishing costs were higher than stated in the offering memorandum and that various instances of managerial malfeasance had occurrred, including undisclosed rent concessions to certian tenants and undisclosed payments to certain entities related to Marney, Orton Investments. Corwin also discovered that VanCaspel owned a substantial portion of the land partnership at the time she was promoting investment in the building partnership.

Corwin and the six other investors filed suit in federal district court on September 4, 1984. Named as defendants were Marney, Orton Investments, the estate of Ronald D. Marney (who had since died in a light plane crash), Suzanne M. Marney (his widow), MOH, Inc., and Marney Properties, Inc. (two Texas corporations originally owned by Marney and Orton that sold interests in the building partnership and managed its property), Sidney Orton [collectively "the Marney/Orton defendants"], VanCaspel and VanCaspel and Company, Inc. [collectively "the VanCaspel defendants"]. The complaint charged the defendants with violations of the Securities Act of 1933, sections 5(a), (c) [15 U.S.C. § 77e(a), (c)], § 12(2) [15 U.S.C. § 77*l*(2)], and § 17(a) [15 U.S.C. § 77q(a)]. The complaint also charged violations of the Securities Exchange Act of 1934, sections 10(b) [15 U.S.C. § 78j(b)] and 20(a) [15 U.S.C. § 78t(a)] and Rule 10b-5. A

RICO claim was included, with alleged predicate acts being federal and state securities law violations, federal mail fraud, and various Texas criminal statutes. Finally, various state law claims were alleged, among them alleged violations of Texas securities laws, breach of contract, breach of fiduciary relationship, misrepresentation and common law fraud, statutory real estate fraud, malpractice, and conversion. Attached to the complaint were several affidavits from the investors and Ferrel.

The Marney/Orton defendants and the VanCaspel defendants each filed motions to dismiss, both arguing that the investors' claims were barred by the applicable statutes of limitations. The defendants also argued, *inter alia*, that the investors had failed to state a claim. The investors' response included a further claim that the VanCaspel defendants violated the Investment Advisors Act of 1940, 15 U.S.C. §§ 80b-1 to 80b-21. In April 1985 the investors received a "cash call" letter from Suzanne Marney requesting an additional $16,667 from each investor. The district judge assigned to the case had resigned and the investors moved for a temporary restraining order in order to obtain an immediate hearing and prevent the forfeiture of their interests in the building partnership. The case was transferred to the docket of another district judge and eight days later he filed an order denying the temporary restraining order and dismissing all of the investors' claims.

The order dismissing the case read in full:

> Plaintiffs' application for temporary restraining order is DENIED for the reason that there is no likelihood that Plaintiffs would prevail on the merits. There is no likelihood that the Plaintiffs would prevail on the merits because there appears from the

> face of the pleading that there is no sound basis for federal jurisdiction over this action. This is so because Plaintiffs' claims under the Securities Acts are time barred and Plaintiffs' attempts to allege an action under RICO allege no "RICO damages" and seek recovery only for alleged injuries suffered as a result of predicate acts.
>
> There being no basis for federal jurisdiction, all claims asserted by Plaintiffs are DISMISSED.

Judgment was entered for the defendants, and the investors appeal.

## II. DISCUSSION

### A. *Claims Under The 1933 Act And The Investment Advisers Act*

The investors' claims under sections 5(a), (c) [prohibiting the sale of unregistered securities] and 12(2) [prohibiting misleading statements in the sale of securities] of the Securities Act of 1933 are time barred. The investors received the offering memorandum in November 1980 and purchased their interests in the building partnership in December 1980, but did not bring suit to challenge the allegedly unlawful and misleading sale of unregistered securities until September 1984. The applicable limitations provision reads as follows:

> No action shall be maintained to enforce any liability created under section . . . 77*l*(2) [section 12(2) of the 1933 Act] of

> this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77*l*(1) [section 12(1) of the 1933 Act, which prohibits violations of section 5, 15 U.S.C. § 77*e*] of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section . . . 77*l*(1) of this title more than three years after the security was bona fide offered to the public, or under section 77*l*(2) of this title more than three years after the sale.

15 U.S.C. § 77m. This provision creates an absolute bar, and the normal tolling rules are not applicable to toll the three-year period. *Summer v. Land & Leisure, Inc.*, 664 F.2d 965, 968 (5th Cir. 1981), *cert. denied*, 458 U.S. 1106, 102 S.Ct. 3484, 73 L.Ed.2d 1367 (1982). Because more than three years elapsed between the offer and sale and the filing of suit, these claims have expired.

The investors' claims under section 17(a) of the 1933 Act and under the Investment Advisers Act of 1940 were properly dismissed because the investors had no private causes of action under these provisions. This circuit has refused to imply a private cause of action under section 17(a), holding that this "general censure of fraudulent practices" does not meet the test of *Cort v. Ash*, 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975)(outlining a four-part test for determining when a private remedy is to be implied

from a federal statute). *Landry v. All American Assurance Co.*, 688, F.2d 381, 384-91 (5th Cir. 1982). Similarly, the Supreme Court has held that "there exists a limited private remedy under the Investment Advisers Act of 1940 to void an investment advisers contract, but that the Act confers no other private causes of action, legal or equitable." *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 24, 100 S.Ct. 242, 249, 62 L.Ed.2d 146, 157-58 (1979). The investors seek damages, not the voiding of an investment advisers contract, and there is no such private cause of action based on this statute.

B. *Claims Under the 1934 Act.*

The investors also advanced claims under section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 ["10b-5 claims"]. The 1934 Act does not fix a specific period of limitations within which a private litigant must bring a suit for damages, nor is any federal statute of limiations generally applicable to private suits for damages under 10b-5. However, courts have fixed appropriate limitations periods as a matter of federal common law. This circuit five years ago determined that the appropriate limitations period for 10b-5 claims in Texas was two years. *Wood v. Combustion Engineering, Inc.*, 643 F.2d 339, 341-46 (5th Cir. 1981). The investors ask us to reconsider that decision or, alternatively, to apply a "discovery" rule which the district court evidently rejected. We reject the former suggestion, while we find merit in the latter.

The *Wood* court applied the rule that a court should adopt "the [limitations] period which the forum state applies to the state cause of action bearing the closest substantive resemblance to the implied cause of action arising under the

federal securities laws." *Id.* at 342 (quoting *McNeal v. Paine, Webber, Jackson & Curtis, Inc.*, 598 F.2d 888, 891 (5th Cir.1979)). *Wood* examined two Texas statutes which created causes of action resembling a 10b-5 claim: the Texas statute on fraud in real estate and stock transasctions, TEX.BUS. & COM.CODE ANN. § 27.01(a)(Vernon 1968) ["the fraud statute"], and the pre-1977 version of the Texas Blue Sky law, TEX.REV.CIV.STAT.ANN art. 581-33 (Vernon 1964). The fraud statute does not contain a time limit within which suit must be brought, but the two-year period of TEX.REV.CIV.STAT.ANN art. 5526 (Vernon 1958)(now codified in revised form at TEX.CIV.PRAC. & REMEDIES CODE ANN. § 16.003 (Vernon Supp. 1986)) is applied to actions based on fraud. *E.g., Wood,* 643 F.2d at 342 n. 5; *Coastal Distributing Co., Inc. v. NGK Spark Plug Co., Ltd.*, 779 F.2d 1033, 1038 (5th Cir. 1986). The Blue Sky law expressly provides that an aggrieved buyer of securities generally must sue within three years after discovery of the untruth or omission (or after discovery should have been made) or within five years after the sale. TEX.REV.CIV.STAT.ANN. art. 581-33(H)(2)(a), (b) (Vernon Supp. 1986).

The *Wood* court examined the elements of the fraud statute and the elements of the pre-1977 Blue Sky law, comparing each to the elements of 10b-5. "Two major considerations, which go to the very heart of the substantive causes of action" convinced the *Wood* court that the pre-1977 Blue Sky law was "significantly broader" than the fraud statute or 10b-5. 643 F.2d at 345. First, reliance was found to be an element of both the fraud statute and 10b-5, but not an element of the pre-1977 Blue Sky law. *Id.* Second, scienter was found to be an element of fraud and 10b-5, but not pre-1977 Blue Sky law. *Id.* Although expressly given less weight by the court than these two considerations, three other factors were mentioned as attributes of pre-1977 Blue

Sky which distinguished it from fraud and 10b-5: (1) the lack of even a "due diligence" defense, (2) the availability of a remedy for purchasers but not sellers, and (3) the requirement of tender as a prerequisite to recovery. *Id.* at 345-46.

The Texas Blue Sky law was amended twice, in 1977 and again in 1979, but we find that these amendments do not alter the conclusion reached in *Wood*. The two "major considerations" of *Wood* have not changed. First, there is still no requirement of reliance. Second, scienter is still not required. We recognized that the three subsidiary factors of *Wood* have all changed: now the Blue Sky law includes a "due diligence" defense,[1] remedies are available to sellers as well as buyers,[2] and a new provision specified that any required tender could be made at any time prior to entry of judgment.[3] While these subsidiary considerations make the Blue Sky law marginally more similar to 10b-5, we do not find the essential pillars of *Wood* to be weakened. *See Keys v. Wolfe*, 540 F.Supp. 1054, 1064-65 (N.D.Tex.1982) (Higginbotham, J.), *rev'd on other grounds*, 709 F.2d 413 (5th Cir. 1983). Accordingly, we find no difficulty in reaffirming *Wood* in holding that the limitations period for 10b-5 actions in Texas is still two years.

Having determined the applicable period of limitations for 10b-5 actions, we must next decide when that period

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[1] A seller or offeror is not liable if he "did not know, and in the exercise of reasonable care could not have known, of the untruth or omission." Tex.Rev.Civ.Stat.Ann. art. 581-33(A)(2)(b)(Vernon Supp. 1986).

[2] Tex.Rev.Civ.Stat.Ann. art. 581-33(B) (Vernon Supp. 1986). This provision also has a "due diligence" defense available for buyers who would otherwise be liable.

[3] Tex.Rev.Civ.Stat.Ann. art. 581-33(E)

began to run. Although state law determines the period of limitations, federal law determines when the period begins. *Breen v. Centex Corp.*, 695 F.2d 907, 911 (5th Cir. 1983). The period begins for 10b-5 "'only when the plaintiff discovers, or in the exercise of reasonable diligence should discover, the alleged violations.'" *Id.* (quoting *McNeal*, 598 F.2d at 893 n. 11). Thus, the investors cannot recover under 10b-5 for violations which they had discovered, or in the exercise of reasonable diligence should have discovered, two years before suit was filed. Although many, if not all, of the alleged 10b-5 violations occurred at the time of the sale in December 1980, this discovery rule must be applied to determine whether the two-year period for filing suit is extended.

The defendants contend first that the investors never raised the discovery issue below and are barred from raising it for the first time on appeal. We recognize that as a general rule issues must be presented to the trial court to receive appellate consideration, unless to ignore them would result in a "fundamental miscarriage of justice." *See Mitchell v. M.D. Anderson Hosptial*, 679 F.2d 88, 91-92 (5th Cir. 1982). The brief order of the district court dismissing all claims gives us no indication whether the discovery issue was considered. However, we find that the discovery issue was raised below, albeit in an oblique manner.

The investors' complaint, aptly described by defendants as "prolix and rambling" in its sixty-three pages of text and sixty-seven pages of attached affidavits and exhibits, suggested that the investors knew nothing about possible wrongdoing until Ferrel's audit. The complaint never mentioned the statute of limitations, tolling rules, or the discovery rule even though the 10b-5 claims were facially barred by the two-year period. The defendant's motions raising the limitations defenses anticipated this issue and

included the charge that "Plaintiff's Complaint does not allege any facts from which this Court can conclude that Plaintiffs, in the exercise of reasonable diligence, could not have discovered the alleged inadequacies of the Offering Memorandum before September of 1982, . . . two years before they filed this lawsuit." Responding to the defendants' motions to dismiss with another venture in meandering verbiage, the investors never explicitly stated that the discovery rule preserved their claims, although they cited extensively from *McNeal, Breen, Wood,* and other cases discussing the principles of the discovery rule. The discovery issue was thus fairly presented to the district court.[4]

Assuming, without deciding, that 10b-5 violations did occur, we hold that the district court erred in failing to apply the discovery rule to the investors' claims. If, as they allege, the offering memorandum and supporting documents were materially misleading or fraudulent, it is not immediately

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[4] We have experienced our own frustration with the prolixity of the investors' counsel. At oral argument we requested him to file a letter brief to point out where he had raised the discovery issue. We found our answer buried in the middle of a thirty-two page brief which was packed with non-responsive record excerpts. On remand it would be appropriate for the district court to call to the attention of plaintiffs' counsel the requirement of Fed.R.Civ.P. 8(a) that a pleading be "a short and plain statement of the claim showing that the pleader is entitled to relief." We recognize that there is a degree of tension between this standard and Fed.R.Civ.P. 9(b), which calls for the circumstances constituting fraud or mistake to "be stated with particularity." However, "Rule 9 must be read in light of the basis pleading philosophy set forth in Rule 8. . . . Thus, although Rule 9(b) calls for fraud to be pleaded with particularity, the allegations still must be as short, plain, simple, direct, and concise as is reasonable under the circumstances." 5 C. Wright & A. Miller, *Federal Practice and Procedure* § 1291 at 389 (1969). Rule 9(b) should not be read so as to obliterate this basic pleading philosophy. *See id.* § 1298 at 406-16.

clear when the investors should have made this discovery. The defendants have as yet advanced no evidence on this issue, relying instead on their assertions that no 10b-5 violations occurred at all.[5] The investors have alleged and supported their contentions that they were not aware of 10b-5 violations until Ferrel's audit. Other than the initial offering memorandum and supporting documents, the defendants have identified no communications or occurrences which would have alerted the suspicions of a reasonably diligent investor. While such evidence may be produced later in this litigation, we find that at the least the investors have raised a genuine issue of material fact. Thus, the issue was inappropriate for resolution on summary judgment. *See* Fed.R.Civ.P. 56(c).

C. *RICO*

The defendants concede that the articulated basis of the district court's dismissal of the RICO claims was erroneous. The district court dismissed because the investors alleged no "RICO damages" independent of the injuries suffered as a result of predicate acts. In an opinion filed after the district court's dismissal, the Supreme Court has held that RICO has no distinct requirement of "racketeering injury" separate from the harm of predicate acts. *Sedima, S.P.R.L. v. Imrex Co.*, ____ U.S. ____, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985); *See also R.A.G.S. Couture, Inc. v. Hyatt*, 774 F.2d 1350, 1354 (5th Cir. 1985). The investors have alleged financial injuries

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[5] The defendants contend, as they did below, that the offering memorandum and supporting documents made full and complete disclosure of the transactions. The district court did not pass on the merits of the 10b-5 claims, and we express no opinion thereon. On remand, the district court may find if appropriate to consider summary judgment motions on the merits.

as a result of various predicate acts, including violations of 10b-5 and federal mail fraud statutes. These allegations are sufficient to withstand a motion to dismiss.[6] *See Armco Industrial Credit Corp. v. SLT Warehouse Co.*, 782 F.2d 475 (5th Cir. 1986) (mail fraud as RICO predicate act); *James v. Meinke*, 778 F.2d 200, 207 (5th Cir. 1985) (10b-5 as RICO predicate act).

D. *State Claims*

The district court dismissed the pendent state law claims for lack of subject matter jurisdiction. There was no diversity jurisdiction, and the district court had dismissed all of the federal claims which created federal question jurisdiction. A district court has "wide discretion" in deciding whether to hear a pendent claim. *United States v. Capeletti Brothers, Inc.*, 621 F.2d 1309, 1317-18 (5th Cir. 1980). "'[I]f the federal claims are dismissed before trial, even though not in substantially a jurisdictional sense, the state claim should be dismissed as well.'" *Id.* at 1318 (quoting *United Mine Workers of America v. Gibbs*, 383 U.S. 715, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966)). Because of our determination that claims under 10b-5 and RICO were erroneously dismissed at this early stage in the litigation, the district court's premise was incorrect. Since subject matter jurisdiction is now present, we reverse the dismissal of the state claims in order to enable the district court to exercise its discretion based on these new considerations. *See Hamman v. Southwestern Gas Pipeline, Inc.*, 721 F.2d 140, 144 (5th Cir.1983). In so ruling, we express no opinion on the merits of these claims.

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[6] We decline the defendants' invitation to proceed to issues not passed upon by the district court and to determine the timeliness or the merits of the RICO claims.

## III. CONCLUSION

We affirm the district court's dismissal of the claims under the Securities Act of 1933 and the Investment Advisers Act of 1940. We reverse the dismissal of the claims under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. We reverse the dismissal of the RICO claims and the various state law claims. We remand for further proceedings not inconsistent with this opinion.

AFFIRMED in part; REVERSED in part and REMANDED.

BY THE COURT

*/s/Robert Madden Hill*
Robert Madden Hill
*Circuit Court Judge*

Dated: April 30, 1986.

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| CHARLES T. CORWIN, D.D.S.; THE ESTATE OF RICHARD P. MULLINS, DECEASED; DONALD T. BOUDREAUX AND PATRICIA E. BOUDREAUX, his wife; DAVID T. CARR, M.D. AND CHRISTINE N. CARR, his wife; JOHN D. DICKERSON, JR. AND JOAN W. DICKERSON, his wife; HAROLD O. HUDNALL AND AUDREY S. HUDNALL, his wife; and ROBERT EMERSON CRATON AND MARY JANET CRATON, his wife; | § | |
| *Plaintiffs,* | § | NO. H-84-3689 |
| v. | § | |
| MARNEY, ORTON INVESTMENTS, a general partnership; THE ESTATE OF RONALD D. MARNEY, DECEASED; SIDNEY ORTON; MOH, INC.; VENITA VANCASPEL; VANCASPEL & CO., INCORPORATED; MARNEY PROPERTIES, INC.; AND SUZANN M. MARNEY, | § | |
| *Defendants.* | | |

FINAL JUDGMENT

In accordance with the Order of the Court entered this date, it is ORDERED, ADJUDGED and DECREED that all claims asserted by Plaintiffs are DISMISSED.

This is a FINAL JUDGMENT.

DONE at Houston, Texas, this 8th day of May, 1985.

*/s/ Ross N. Sterling*
Ross N. Sterling
*United States District Judge*

Dated: May 8, 1985.